



Response from ICAS

VAT registration threshold: call for evidence

6 June 2018

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members.
2. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

3. ICAS welcomes the opportunity to contribute to the consultation 'VAT Registration Threshold: call for evidence', issued by HM Treasury in March 2018. We are also grateful to the Treasury and to HMRC for meeting with our members to discuss the consultation.

Comments on specific areas

The current VAT Threshold and the impact on business growth

Question 1: What experience or knowledge do you have of small businesses managing their turnover to remain below the VAT threshold?

4. ICAS regulates almost 1,000 firms which act as business advisers to Owner Managed Businesses (OMB). Their experience is reported to us via ICAS committees, members' queries, conferences and direct contact.
5. It is over simplistic to attribute the bunching of small businesses at turnover levels just below £85,000 exclusively to a desire to avoid VAT registration. Growing a business beyond this size is likely to require the hiring of staff, and concerns about the contractual burden and complexity of assuming that responsibility looms large as a barrier to that growth. Potentially that is a greater concern for businesses than facing VAT registration.
6. Also, sparsely populated rural areas present specific problems regarding business growth. The limited availability of potential customers impacts on growth.

Question 2: Are there, in your experience, particular types, regions or sectors of businesses where this is particularly prevalent?

7. Business to Customer (B2C) businesses face major problems as they approach the £85,000 turnover threshold. If market conditions do not allow them to increase prices to compensate, they face a hit to their profits by absorbing the VAT. Unless they have significant input VAT to recover, they could face a hit of £10,000 p.a. or more. This burden is particularly ill timed since it exacerbates the amount of growth they must achieve to sustain a business which is also likely to have reached a size to be unmanageable without recruiting staff.
8. Particular sectors mentioned to us include retail sector, hospitality and catering, service industries and furnished holiday letting.

Question 3: What is your experience of competition challenges faced by registered traders just over the threshold, compared to unregistered businesses? If challenges exist, what effect do they have on the ability of registered businesses to grow?

9. Our experience is that B2C businesses face difficulty in competing against unregistered competitors.
10. We also find that small VAT registered businesses suffer particularly from the complexity of VAT. The complexities of zero rate, exempt rate, hot food, cold food, 5% rates, 20% rates certainly frighten clients, not to mention partial exemption. Many small businesses

face a real barrier in obtaining professional advice to deal with VAT issues as the costs of that advice places a great strain on their resources. They do not find HMRC provides adequate support. Some report difficulties in getting through to HMRC's helpline. Some report that the interaction they have with HMRC is inadequate to get to the bottom of their issues. As an example, a charity expected zero rating on an annex based on its study of published guidance, but ultimately found that was not available as the extension test was not met. There had been insufficient support from either written guidance or a helpline call to assist them to ask the correct questions in order to reach the correct liability conclusion on an issue of particular complexity.

Question 4: As the OTS suggest, does the current threshold contribute to the size of the hidden economy, and how?

11. In our experience, most people want to be compliant with the law. The exceptions who try to evade tax appear to present a risk to the tax authorities at any stage of business growth. However, in recent years the profiling of damage done to the common good when businesses and individuals shirk their share of the tax burden has impacted public opinion. The potential costs faced from losing public goodwill could be influential on potential evaders.
12. Dishonesty is involved if turnover is deliberately suppressed by failing to record or report income. How potential VAT registration affects such dishonesty is an open question. It certainly substantially increases the risk – exposing the business to potentially crippling penalties and backdated registration as well as direct tax liabilities and penalties.

Question 5: In your experience, does the current threshold have any effect on growth and/or productivity? If so, how significant is that effect?

13. We see examples of businesses who close for part of the year or reduce their working week to stay below the VAT threshold. However, as referenced in our response to question 1, it is over-simplistic to see this as exclusively VAT focused. For example, a bed and breakfast business taking the decision to close over winter was partly prompted to avoid customer criticism that prices did not fall in quiet periods. The business owners observed profitability fall in quiet spells; for example, having to heat all common areas despite the lack of guests. The combination of lower profitability and customer disgruntlement that prices could not fall in quiet times were further motivators to close for part of the year, as is the desire of many undertake property maintenance.
14. The effect on overall economic growth and productivity of the current threshold may be limited for a wide-range of short-life start-up businesses. Of more significance is the cliff-edge nature of the transition. The true barrier to growth lies more with the immediate hit to profitability for B2C traders that in the absolute level of the threshold.

Administrative Burden

Question 6: Does the administration of VAT discourage businesses from registering?

15. VAT administration is a burden for small businesses. Since driving a small business can involve long hours of work away from family, it is typical to want to dedicate any time away from business to family life. Businesses are wary of introducing obligations which squeeze family time even more.

Question 7: If so, what are the main aspects of VAT administration that are putting businesses off registering?

16. Businesses need certainty and the complexity of VAT threatens that. Complexity in VAT is not dependent upon scale and it applies just as much to small businesses as it does to large. Sadly, the adverse impact of complexity is especially felt in small businesses. People are forced into a complicated system and they cannot afford the professional advice which is available to guide their larger counterparts. The free guidance published by HMRC is of limited assistance. Ideally guidance would be reliable, appropriate and tailored to give businesses the certainty they need to grow.

Question 8: For businesses that have gone from being unregistered to registered, is there a difference between the perception and reality of VAT administration? Was the administration easier or harder than anticipated?

- **If harder, why was that? (For example, a struggle to understand what your obligations were, or you made mistakes)**
- **If easier, why was that? (For example, received the right support from HMRC, at the right time)**

17. We are not persuaded that the complexity, risk and time consumption of VAT compliance proves to be less than feared once traders are registered. The transactional nature of VAT and the existential threat posed to businesses when penalties are geared to turnover, rather than profit, contributes to this. Our experience is that people are correct to perceive they face risk from VAT, as we see cases at Tribunal where penalties are issued by rote without due weight given to mitigating factors.

18. Our view is that VAT should be made straightforward for the newly registered. We commend the cash accounting scheme as being of genuine assistance. We cannot currently say the same for the flat rate scheme because recent amendments to tackle abuse have effectively negated its value for all. Amending it again to reinstate its simplification value without leaving it vulnerable to abuse is worthy of consideration.

19. Some of our members report that their client experience has been that the VAT threshold trigger has been a point for businesses to consider investing in better book-keeping systems e.g. cloud-based accounting packages, so while there is more administration as a result of VAT, overall this has reduced due to automating and integrating all financial processes. One benefit for businesses to moving over the VAT threshold is being forced to keep accounting records up to date and often a better financial understanding/control as a result.

Question 9: How well do current simplification schemes address these issues?

20. In the past we felt the flat rate scheme operated as a genuine simplification. However, recent changes made to tackle abuse have effectively negated its usefulness, not only for the abusers but for all. Ideas to revitalise this simplification were discussed at our meeting with HMT/HMRC on 16 May 2018 and, although these represent the ideas of some members rather than a firm ICAS position, these are summarised below because they sparked interest at that meeting.

21. There was interest in a discussion on a flat rate scheme which could be opted for in the turnover range £85 K to £250K. This is simply an option with businesses free to follow full VAT law if they wish.

22. Businesses below £85K who chose to voluntarily register would not be permitted to use flat rate scheme to avoid abuse.

23. To reward businesses for growing to the VAT threshold there would be a graduating discount in initial years; potentially 3% in year 1, 2% in Year 2 and 1% in year 3. These discounts would be protected from abuse by anti-avoidance applying for TOGC and phoenix companies.

24. On reaching the £250K threshold, businesses would follow full VAT rules and fall into the MTD regime.

Question 10: Ipsos MORI research suggests that dealing with VAT returns are likely to be the most time consuming aspect of VAT administration. What is it about VAT returns that are particularly time consuming for small businesses?

25. The respondents to surveys are a self-selected group. We have concerns that there are VAT registered businesses who need much wider help than just streamlining to their return submission. The complexity of VAT and the potentially drastic consequences of error are a major concern, particularly in light of the difficulties small business has in obtaining bespoke advice.

Question 11: Will new technology, such as the introduction of MTD, facilitate changes or simplifications in VAT administration? If so, what are they, and what changes would you like to see in response?

26. Since professional advisors do not yet know what it will be like to cope with MTD, small businesses cannot be expected to understand the consequences for them at this stage. We anticipate that MTD's introduction will exacerbate the threshold effect, at least initially. It is possible that some B2B businesses, despite not facing the same squeeze on profits as their B2C counterparts at the point of registration, may join in keeping below the threshold because of reluctance to use IT or because of aversion to having to adopt a specific way of working.

Financial and Competitive burden

Question 12: In your experience, what, if any, are the sectors that are particularly affected by the financial costs and competitive disadvantages of registration discussed in 3.15-3.20?

27. B2C businesses and labour-intensive businesses are particularly affected by the costs and competitive disadvantages of registration. As mentioned in question 11, the introduction of MTD may add another group who will have concerns about reaching the registration threshold.
28. As discussed in question 8 above, the sectors most affected include retail sector, hospitality and catering, service industries and furnished holiday letting. It may be that a widening of the 5% rate, post Brexit, could assist these types of businesses in crossing the registration threshold.

Question 13: In your view, do these financial costs and competitive disadvantages lead to businesses managing their turnover below the threshold? How significant is this effect on SME growth?

29. These factors are part of the picture on why small businesses make their decisions on how much to grow their businesses. The full picture is more complex, containing other factors including reticence to take on the responsibilities and complexities of becoming an employer. Although the views of our members are divided on where the VAT registration threshold should be set, it is a widely held concern about the complexity of VAT for very small businesses which do not have the resources to afford professional advice.

EU SME proposal

Question 14: What in your view would be the likely impacts of the EU's proposal on the administration of VAT for SMEs, and how in particular will it help incentivise SME growth?

30. The answer to this in regard to the UK will depend upon the arrangements for cross border trade between the UK and the EU after the post Brexit implementation period comes to an end. Those arrangements, or even the UK's desired aim for them, are not yet known.

Question 15: Are there constituent parts of the proposal which are particularly attractive or unattractive? If so, what are they and why?

31. The proposal to permit businesses with turnover up to €2,000,000 to lodge annual VAT returns without interim payments rings alarm bells because of the danger that businesses will not cash manage the VAT they collect efficiently, thus being unable to pay their liability when it eventually falls due. In addition, an annual return puts the onus on the trader to be disciplined over record keeping. With the multifarious pressures on a small, growing business, that brings risks. The EU wide threshold may raise issues because, despite the EU VAT Directive, differences do exist in VAT treatment between Member States.

Administrative smoothing

Question 16: Do you think the mechanisms described in paragraph 4.8 would help businesses better manage the administration of VAT, upon registration? If so, would the positive effect be significant?

32. The spread of the threshold test over 2 years would be welcome but extending the first period raises the worry that inexperienced people may make cash management mistakes early on in their registration and these are necessarily amplified if their initial return is delayed.

Question 17: Would any of these solutions be sufficient to change the behaviour of businesses that take measures to remain under the threshold?

33. The key step to changing business behaviour into being relaxed about VAT registration is to offer a route which is straightforward for them, like a well designed simple flat rate scheme. It then becomes a trade off decision for them. Either they invest the effort into becoming expert on VAT law, which might prove their lowest cost option, or they can avoid that burden and have certainty that they are fully compliant with the simplest of calculations.

Question 18: Are you aware of any simplification schemes from around the world, that work particularly well? If so what are they?

34. We have no evidence to share on this question.

Financial smoothing

Question 19: What is your experience of the type of mechanisms outlined in paragraphs 4.10-4.15? Would they be effective in incentivising business growth in the UK? If so, how and why?

35. A note of caution on financial smoothing is that it introduces further complexity.

Question 20: In your view, are there any other solutions that could work? What are they and why would they work?

36. See comments on flat rate scheme in question 9.

Question 21: The EU Commission SME proposal introduces the idea of essentially two thresholds. The first, lower threshold exempts small businesses from the financial obligations of VAT. The second, higher threshold exempts slightly larger businesses from some of the administration of VAT. What do you think about this proposal?

37. These proposals do not contribute to simplicity; two thresholds would also generate compliance issues. Attempting to cut workload by introducing an annual return is highly risky for less organised businesses with poor cash management.

Question 22: Assuming the UK has the freedom to do so, would increasing or decreasing the threshold simply move the threshold problems or alleviate them?

38. Changing the threshold will not resolve problems in isolation. A decreased threshold will see more businesses challenged by the complexity of VAT. That will place an escalating burden on HMRC which they are not resourced to meet. The concern of facing VAT responsibilities without adequate support may deter people from launching businesses. A change to increase the threshold is likely to move the problem, although setting the threshold at a much higher level (say tripling it) would address the issue of businesses being so small they have no resource of professional assistance.